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Minnesota Task Force

on

Post-Secondary Funding

*Final Report to the
Legislature and Governor*

1993

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Minnesota Task Force on Post-Secondary Funding

Appointed Members

Dr. Darrell Krueger, President, Winona State University, Chair
Senator Joanne Benson
Representative Lyndon Carlson
Representative Tony Kinkel
Senator LeRoy Stumpf
Ms. Lois Josefson, Attorney, Fergus Falls
Ms. Judy Neppel, Vice President, East Grand Forks
Mr. David S. Hong, Economic Analyst, New Brighton

Designated Members

University of Minnesota - President Nils Hasselmo, represented by David Berg
State Universities - Chancellor Terry MacTaggart, represented by Edward McMahon
Community Colleges - Chancellor Geraldine Evans, represented by Eric Radtke
Technical Colleges - Chancellor Carole Johnson, represented by Diane Paulson
Private College Council - President David Laird, represented by John McGee
Department of Finance - Commissioner John Gunyou, represented by Ron Hackett
Student Advisory Council - Mr. Scott Olson, Minnesota Community College Student Association

Minnesota Task Force

on

Post-Secondary Funding

Final Report

Charge

As a key provision in its 1991 omnibus education bill, the Minnesota Legislature created the Task Force on Post-Secondary Funding, with eight members appointed by the Legislature and Governor and seven members designated by their positions in the higher education field. The group's charge was to:

Develop an alternative funding formula for post-secondary education that will create incentives for quality education while maintaining access for students, and that can be funded within the projected constraints of the state budget in the coming decade.

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State Funding of Higher Education

Minnesotans' commitment to education, present since the earliest days of the Minnesota Territory, has endured for nearly a century and a half, bringing uncommon benefits to the region and its residents. Today, the state's public higher education enterprise encompasses a wide range of activities carried out by 66 institutions within four higher education systems that are governed under distinctly different missions. The state's investment is substantial, representing nearly 13% of total state general fund spending in the 1992-93 biennium.

The adoption of Average Cost Funding (ACF) in 1983 represented the first time the state established an explicit formula by which to appropriate funds to all higher education systems. Not long after its adoption, concerns about ACF surfaced. Enrollments in higher education began to swell in the late 1980s and, in the 1990s, pressures on state finances from growing K-12 enrollments, uncontrolled health care costs, and the aging of the state's population placed additional

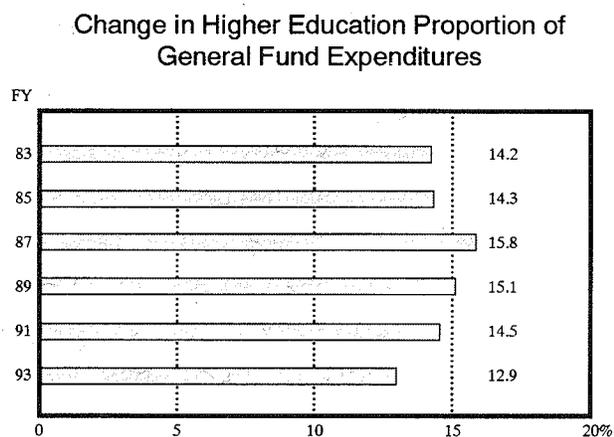
through an enrollment-related approach that emphasized student-staff ratios as a measure of needed change. Additionally, a limited amount of funding was targeted at those campuses that were too small or specialized to receive sufficient enrollment-related funds (primarily Southwest State and Metropolitan State).

In 1977 the Legislature adopted a stopgap mechanism in preparation for the significant decline in enrollments that the Higher Education Coordinating Board (HECB) projected. This was known as bulge funding. Bulge funding was based on the principle that the systems and campuses could accommodate temporary enrollment fluctuations (bulges) within their bases. The Legislature froze the enrollment recognized for funding purposes at the 1977 level in the belief that the coming declines would soon offset any temporary increases. When enrollment gains proved to be greater than projected, the Legislature modified the bulge policy by appropriating funds to the State University System and the Community College System for enrollments exceeding certain levels.

Area vocational technical institutes (now technical colleges) were funded separately through the K-12 bill, primarily based on programmatic costs. Enrollment changes were not funded; it was left up to a campus to determine how many students could be accommodated in a particular program. Additional categorical aids were provided by the Legislature for specific purposes.

The state also provided funds in the 1970s to private colleges through the Private College Contract Program. Colleges received a per capita subsidy of \$120-\$150 for every Minnesota student enrolled and \$400-\$500 for every Minnesota state grant recipient enrolled. Funding for this program was suspended during the fiscal crisis of the early 1980s. Funding was repealed when the new state grant program was adopted in 1983.

As the 1980s approached, the HECB sounded concern, noting that the state's current funding policies and procedures were developed in a time of enrollment growth and fiscal prosperity. The HECB, questioning whether declining enrollments and fiscal constraints anticipated during the 1980s and 1990s warranted maintenance of current policies, began in 1979 the process that ultimately would produce a set of integrated policies to guide state funding and governance of higher education.



constraints on the state's resources. This set the stage for debate about quality and access in higher education within limited state resources.

The Minnesota Legislature in 1991 responded by ordering a comprehensive study of post-secondary education funding and recommendations on an alternative formula.

Prior to the adoption of ACF in 1983, funding for collegiate higher education was based on several different approaches. Most funding was appropriated

Average Cost Funding

ACF relates instructional funding to academic program costs and student enrollment. State appropriations provide 67% of total instructional cost for the University of Minnesota, State University System and Community College System, and 73% of instructional cost for the Technical College System. The remaining portion of the instructional cost is expected to be raised through tuition revenue. Governing boards set tuition rates, which may vary by program, level of instruction, or other criteria.

Instructional spending levels are determined on the basis of average instructional cost per student by level (lower division, upper division, graduate, professional) and type (low, medium, high cost). Levels and types of instruction are combined (lower division/low cost, for instance) to form cost "cells," as seen in the adjacent table. Program costs are differentiated by level and type to ensure that appropriate weight is given to the various mixes of enrollment by cost of academic program.

Enrollment then is attributed to each cell. The formula uses Full Year Equivalent (FYE) enrollments from two years prior to the year for which the appropriation will be made, a funding method commonly referred to as the "two-year lag." This lag was intended to provide a cushion against anticipated enrollment declines. Costs were intended to be calculated across the enrollment of all categories of students; the Legislature later began to exclude certain student categories from these calculations.

In addition to financing instruction through ACF, the state also provides funding for some non-instructional activities. Community service, research, state university and community college intercollegiate athletics, other miscellaneous items, and the proportion

"The current Minnesota funding process is almost all quantitatively driven, grounded in old snapshot data that purports to be value neutral but that has values that opt for preserving the status quo rather than asserting the leadership and management responsibilities of the systems and campuses."

University of Rhode Island President (and former Minnesota State University System Chancellor) Robert Carothers: testimony before Task Force on Post-Secondary Funding

Sample Average Cost Funding Matrix

	FY '93 Cost	FY '91 FYE	Total Expend.
Lower Division			
Lower Range	\$4,000	\$11,000	\$44,000
Mid Range	4,000	16,000	64,000
High Range	5,000	4,000	20,000
Upper Division			
Low Range	5,000	14,000	70,000
Mid Range	6,000	4,000	24,000
High Range	10,000	2,000	20,000
Totals		\$51,000	\$242,000

of indirect costs associated with these activities are generally classified as noninstructional. The size of the noninstructional appropriations varies considerably by system, stemming largely from differences in mission. During the 1992-93 biennium, noninstruction ranged from 1% in the Technical College System to 35% at the University of Minnesota, reflecting the strong research and community service components of the University's mission.

The noninstructional appropriation reflects only a portion of each system's total non-instructional expenditures. All of the systems receive funding from other sources (federal grants, dormitory revenues, etc.) for noninstructional activities and, in some cases, the systems receive revenues for activities that are also supported by state direct appropriation.

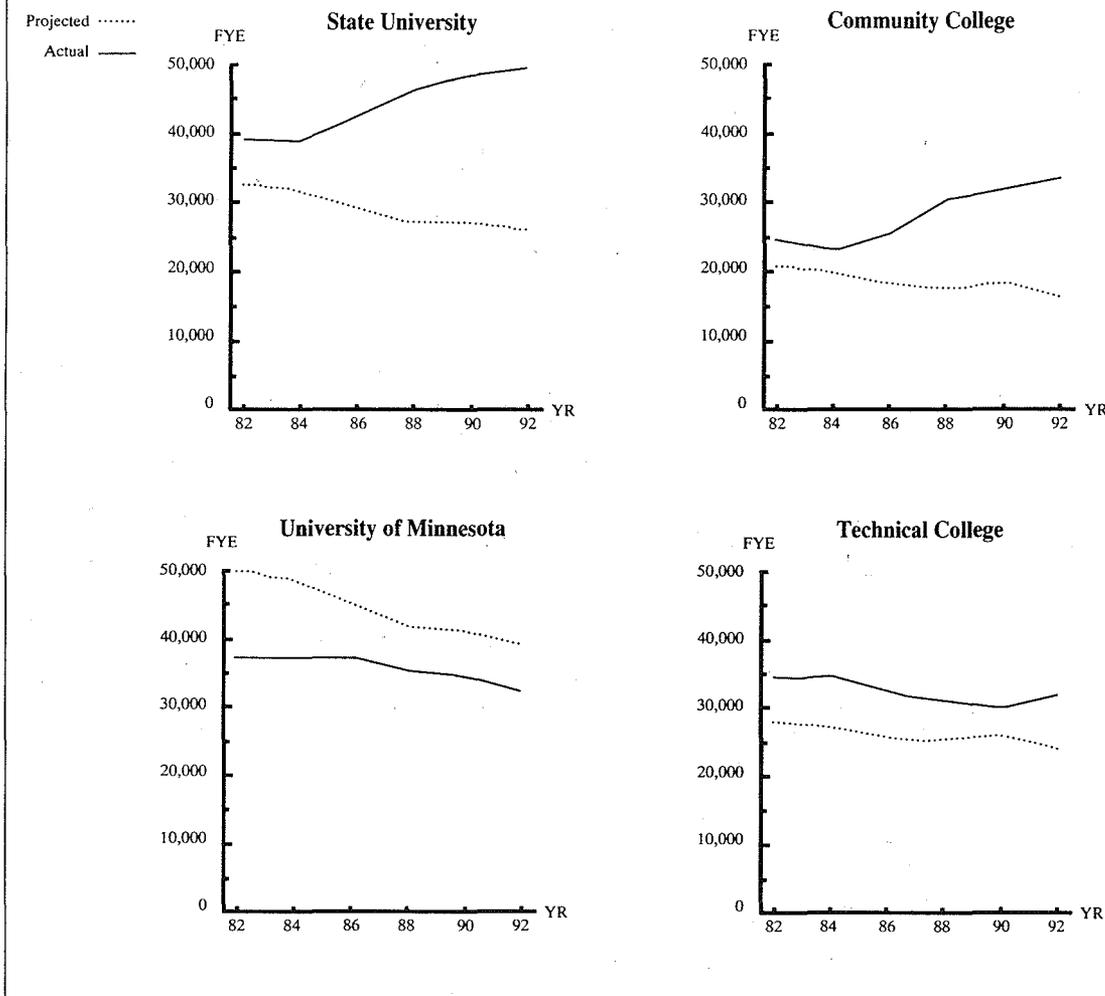
Results of ACF

The ACF formula was an innovative proposal when introduced: it provided integrated policies to guide funding and governance of higher education, greater equity in funding, specific recognition that necessary per student costs vary by program and level. It also shifted the focus toward instructional dollars available per student and away from the previous staffing ratios methodology.

However, a problem with ACF is that it was built upon what the higher education systems viewed as inadequate appropriation bases. As a result of state budget shortfalls in 1981 and 1982, appropriations were reduced to all of the systems; thus, when ACF was adopted in 1983, each system was operating on a reduced appropriation base and an increased tuition level.

Additionally, the assumption that enrollments would decline proved false; between 1983 and 1992,

1979 Projections Compared to Actual Enrollments



undergraduate headcount enrollment in Minnesota's public higher education systems grew by 29,978 students and FYE numbers increased by 13,279, as seen in the table above.

While the HECB predicted enrollment declines, the reductions were pegged only to a decline in secondary school enrollments. No one predicted the effects of the baby boom on the growth in non-traditional student numbers, work force retraining needs requiring higher education, or the longer time to program completion.

Another factor in enrollment increases was the resourcefulness of the higher education systems and campuses to enlarge the pool of potential students through program development and more effective marketing strategies. All of the incentives in ACF favored seeking new markets and, while no urging was probably necessary, a state blue ribbon commission on higher education chaired by former Governor Elmer L.

Andersen in 1984 advocated such activities as a means of protecting systems and campuses.

The growth in enrollment under the two-year lag policy was jeopardizing educational quality according to the higher education systems, because instructional dollars were being spread ever more thinly across an expanding student population as systems and institutions participated in the enrollment race.

The University of Minnesota successfully appealed to the Legislature in 1987 to remove it from ACF as part of its Commitment to Focus plan. This allowed the University to decrease undergraduate enrollments while maintaining appropriations, so that it might improve its quality by increasing instructional spending per undergraduate student. In return, the University pledged to demonstrate to the Legislature its ability to meet and maintain lower enrollment targets.

Enrollments in the State University and Community College systems were escalating, and those

systems feared that reducing the number of University of Minnesota undergraduates would result in additional increases and further exacerbate problems related to lag funding. The Legislature in 1988 responded to these systems' concerns by implementing marginal cost funding, which provided 65% of the average instructional cost (divided between state appropriation and tuition) for students not recognized under the two-year lag.

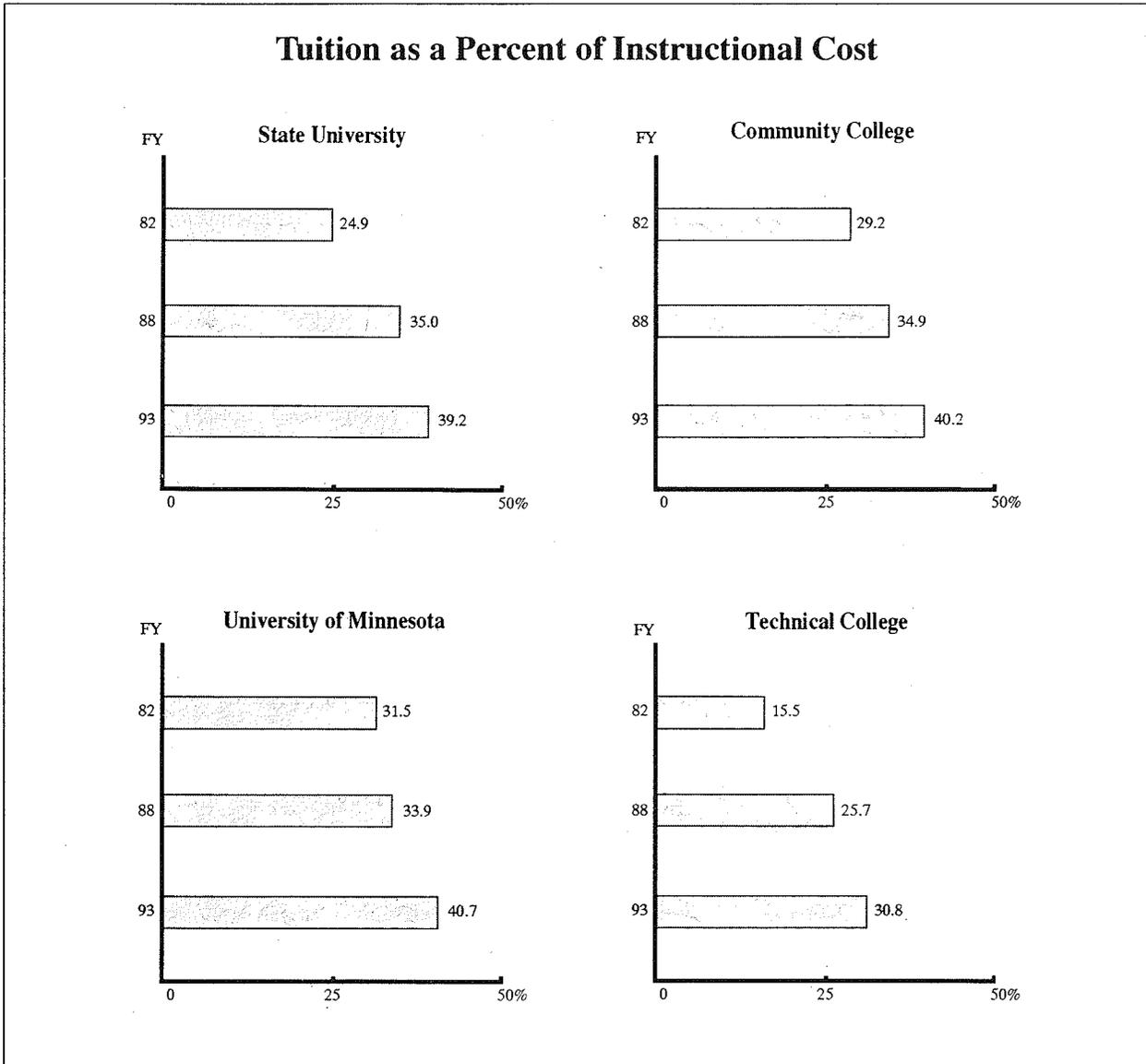
By 1990 worries were being widely expressed about the impact of not recognizing educational quality in the funding model. The State University System brought forth a quality initiative and then-Chancellor Robert Carothers argued before the Legislature that ACF was a formidable barrier to improved quality. The Community College and Technical College systems also developed their own quality initiatives and voiced concern about achieving improvements in light

of the available resources and formula incentives.

Access with Quality

By 1991 the Legislature began to search for a means to pursue a strategy of maintaining student access while improving educational quality. State fiscal problems and continual tuition increases led the Legislature to make several changes to the formula in an attempt to give higher priority to Minnesota, on-campus, degree-seeking students and, in the process, the Legislature took definitive steps to replace ACF with a new formula.

One of these steps was the creation of the Task Force on Post-Secondary Funding to develop a mechanism that would create incentives for financially accessible, quality higher education within current budgetary constraints.



Task Force Proceedings

The task force operated on an informal basis to encourage discussion. Positions of the task force were adopted by majority vote. During early task force meetings, members identified information that they needed and developed agendas to meet these needs. In these early sessions it became clear that members desired:

- thorough briefings on funding mechanisms considered by the 1980 Future Funding Task Force, as well as additional analysis of the ACF formula;
- input from the state's higher education providers and consumers;
- advice from national experts on the subject of higher education funding; and
- information and analysis on various funding mechanisms employed elsewhere in the nation.

"Budget formulas should reinforce the distinctiveness of the different higher education systems and institutions. This may require a different formula for each type of system, or a single formula with some variables that apply only to certain institutions or systems."

National Center for Higher Education Management Systems
President Dennis Jones and NCHEMS Senior Associate Peter Ewell: testimony before Task Force on Post-Secondary Funding

Witnesses

In addition to system and campus budget experts, numerous people provided assistance to the task force by appearing as witnesses. In order of their appearances, they include:

- Bernard Brommer**, President, Minnesota AFL-CIO
- James Johnson**, President, Minnesota High Technology Council
- Robert Vanasek**, Executive Director, Minnesota High Technology Council
- Thomas Triplett**, Executive Director, Minnesota Business Partnership
- William Blazar**, Vice President of Government Affairs and Public Policy, Chamber of Commerce
- Dr. Dennis Jones**, President, National Center for Higher Education Management Systems (NCHEMS)
- Dr. Peter Ewell**, Senior Associate, NCHEMS
- Dr. Anne Hopkins**, Vice President for Arts, Sciences, and Engineering, University of Minnesota
- Dr. Kathleen Sell**, Associate Vice President for Budget and Finance, University of Wisconsin
- Dr. Aims McGuinness**, Director of Higher Education Policy, Education Commission of the States
- Dr. Robert Carothers**, President, University of Rhode Island, former MSUS System Chancellor

Testimony

A common theme emerged from discussions with Minnesota business leaders and recognized experts within the field of higher education — an emphatic plea to the task force to be certain its recommendations would place a high premium on enhancing educational quality. Speakers cautioned that a formula based exclusively on enrollments cannot achieve this.

Competitiveness

James Johnson and **Robert Vanasek** stated that Minnesota companies are having trouble competing in the global marketplace, a condition that will worsen if education funding strategies do not change. They also suggested that improvements in quality need not automatically translate into more money.

Some business leaders made other suggestions, including giving students and parents more power, paying more attention to business feedback, and considering more emphasis on grants to students rather than to institutions.

Performance Incentives

Dr. Dennis Jones and **Dr. Peter Ewell**, from NCHEMS, testified on how formula funding works in higher education and ways to include performance incentives in formulas. The use of funding formulas began, they noted, at a time when public systems of higher education and their budgets were growing. States did not adopt formulas because they wanted to encourage higher education systems to behave in certain ways or to encourage certain outcomes, but because they were concerned about fiscal accountability.

Ewell and Jones argued that this philosophy of viewing higher education as a “public utility” is being succeeded by a model that views higher education as a public service and strategic investment, turning the states’ attention toward “product quality” and outcomes.

They presented a strong case for a funding policy that separates the higher education budget into two components: base and incentives. The base, a significantly larger portion, provides for operations at a base level of service as defined by system or institution mission. The base can be funded incrementally or through a formula; each method has the same basic growth and price change variables.

Accountability for the base, Ewell and Jones noted, historically has been defined in purely financial terms: did you spend the money in the way we intended? A predictable base enhances institutional stability, so that measuring accountability becomes a question of whether responsible stewardship has been exercised.

Incentive funding should be designed to accomplish specific objectives that can be tied to performance. Incentive mechanisms are appropriate for allocating funds in return for the achievement of certain state goals. Examples could include access, retention, program completion, the production of graduates in certain fields, or applied research that addresses specific state needs.

Quality and Accountability

Dr. Aims McGuinness advised that certain factors must be considered in implementing a formula to promote greater quality and accountability in higher education. McGuinness argued for simplicity in funding mechanisms, noting that the more complex the formula, the more it generates debate over the factors that went into it, and the more quickly it becomes obsolete. Establishing renewed concern for education, he said, can be aided by a formula that utilizes a relatively simple basis for allocating most of the money and uses funding on the margin to define a public agenda. The public agenda can target certain state goals and focus the attention of the Legislature.

McGuinness cautioned the task force that accountability is much more a relationship of trust than fulfilling a set of indicators. When that trust is established, McGuinness said, both education and the public will benefit.

“Full participation in society may require education whether jobs do or not,” he said. “Education is the key to mobility and life-style. The country needs an educated citizenry. Places with better educated people often have a better quality of life and this is where businesses and educated people want to locate.”

Public Policy

Dr. Robert Carothers provided task force members with a course of action that he believes could substantially benefit Minnesota. It also is a course, he noted, requiring wholesale change that will be achieved only with great difficulty.

Nothing will happen, he maintained, until the Legislature and Governor set forth a few clear and simple public policy goals for higher education. The goals must be projected and maintained, preferably for a decade but certainly no fewer than five years. “Minnesota does wonderful things in higher education, but it has not been able to articulate state public policy goals in this area,” he said. “Because of this, resources are spread very thinly and we fund lots of good ideas without any clear sense of purpose or without any way to evaluate progress toward any goal.”

Once the public policy goals are developed, a strategic plan should be designed to implement that policy and budgeting then becomes one of several tools used by management to complete the plan.

The current process is almost exclusively driven by quantity that is grounded in old snapshot data. These data purportedly are value neutral, but in reality they work to preserve the status quo, rather than stressing leadership and management responsibilities of the systems and their campuses.

Mission Differentiation

Dr. Anne Hopkins, a vice-president at the University of Minnesota, was formerly an administrator at the University of Tennessee, Knoxville. Tennessee was a pioneer in the use of performance based funding, and Hopkins offered advice from the lessons she learned there.

The state government in Tennessee established standards for performance and the mechanisms to measure them. In many cases, these were of questionable value. Among her concerns on measurement were the application of tests and surveys that did not truly measure academic quality.

Hopkins cautioned the task force to use care in devising and setting standards because incentives may backfire. Setting a specific graduation rate may lead to excluding many students from college or to reducing graduation standards. In this sense, assessment systems are open to manipulation to make everyone look successful.

The most important concern for the task force, she suggested, will be to exercise sensitivity in considering the differences in mission and purpose of the various systems and institutions. More work is needed on mission differentiation since institutional success cannot be determined until there is a clear understanding of what the institution is — something that also affects funding strategies.

State Goals

Building on suggestions in the experts' testimony, the task force agreed that its funding recommendations should be based upon pursuit of general statewide goals for higher education. Development of those few, critical objectives would be the key next step, since funding strategies ultimately would flow from them. Earnest discussion of those broad guidelines became the focus of several meetings. How to effectively meld a long list of thoughts and concerns into several clearly stated policy objectives, though, seemed a major task.

The Rochester division of IBM, in response to a task force request, provided assistance by inviting the task force to use its facilities and software to help in the goal development. Members spent an afternoon brainstorming about state objectives and then used the advanced technology to distill their thoughts into general themes. Staff members worked those general themes into a document that the task force further refined.

The task force then adopted the document as a statement of state level objectives that should guide Minnesota's higher education enterprise and that should be reflected in and promoted by state funding strategies.

"Full participation in society may require education (whether jobs do or not). Education is the key to mobility and lifestyle. The country needs an educated citizenry. Places with better educated people often have a better quality of life; this is where businesses and educated people want to locate."

Education Commission of the States Director of Higher Education Policy Aims McGuinness: testimony before Task Force on Post-Secondary Funding

Minnesota's Statewide Objectives for Higher Education

Minnesota's higher education investment is intended to provide an education that encourages creative thinking, fosters a sense of fulfillment, promotes flexibility to respond to a changing world, provides a wholesome environment in which to learn, creates a vision for world leadership in thought, word, and deed, and finally, increases the standard of living of the state's citizens.

Specifically, that investment is made in pursuit of the following objectives:

PROMOTE DEMOCRATIC VALUES – To enhance Minnesota's quality of life by developing understanding and appreciation of a free and diverse society

ENSURE QUALITY – To provide a level of excellence that is competitive on a national and international level, through high quality teaching, scholarship and learning in a broad range of arts and sciences, technical education and professional fields

FOSTER STUDENT SUCCESS – To enable and encourage students to choose institutions and programs that are best suited to their talents, interests and abilities, and to provide an educational climate that supports students in pursuing their goals and aspirations

MAINTAIN ACCESS – To provide an opportunity for all Minnesotans, regardless of personal circumstances, to participate in higher education

ENHANCE THE ECONOMY – To assist the state in being competitive in the world market, and to prepare a highly skilled and adaptable workforce that meets Minnesota's opportunities and needs

Funding Priorities and Criteria

The task force moved from its consideration of state objectives to debating funding priorities within each system. Members engaged in extensive discussions on whether funding strategies should vary to reflect differences in system missions, student and enrollment characteristics, and educational activities. Through a survey prepared by staff, members weighted priorities by system and discussed the relationship of the priorities to funding strategies. Survey results confirmed the significant differences in missions and priorities among the systems.

The instructional mission in higher education serves many different types of students. Examples include: lower division students, some of whom are degree/certificate-seeking; upper division students, some of whom are degree-seeking; practitioner graduate students, some of whom are combining instruction with employment experience; professional degree students; doctoral program students; students enrolled through continuing education/extension; students participating in the post-secondary enrollment options program; non-resident students, some from non-reciprocity states; students enrolled at off-campus sites; and students from families of widely varying income levels.

In addition to the need for a simple formula to accommodate system differences, the task force identified other standards that any recommended funding formula must meet, including:

- strengthening system and campus accountability and autonomy;
- preserving stable base level funding;
- providing incentives to improve performance; and
- recognizing fiscal, political and educational realities.

Finally, the task force suggested considering, in light of its findings and criteria, whether the proposal is better than ACF.

“Overall, the most important thing (for the task force) is to be sensitive to differences among missions and purposes of the different higher education systems and institutions in the state.”

University of Minnesota Vice President for Arts,
Sciences and Engineering Anne Hopkins: testimony
before Task Force on Post-Secondary Funding

Proposals Submitted

As an integral component in determining recommendations to the Legislature and to continue a broad level of input, the task force issued invitations to the public higher education systems, institutions and others to prepare funding proposals for its consideration. The four proposals received are outlined below.

In analyzing the proposals and suggestions, the task force noted they contained many common elements, and discussions centered on which elements represented true strengths.

“Minnesota companies are not able to compete globally. If we continue to fund (higher education) as we are, we will continue to fail.”

Minnesota High Technology Council President James Johnson: testimony before Task Force on Post-Secondary Funding

Institutional Proposal

- "Base-plus" concept for formula.
- Guarantee on a dollar per student basis, determined by comparison to peer institutions and monitored by quality indicators.
- Competitive enhancement funding for new and innovative educational practices to be added to base.

Joint Systems Proposal

- "Base-plus" concept for formula.
- Formula funds instructional base including a fixed cost component, both subject to adjustment for enrollment changes.
- Incentive grants on a biennial basis with clearly identified outcomes and performance evaluation before money may be rolled into the base.
- Noninstructional funding subject to performance indicators.

Task Force Member Proposal

- Funding for research, physical plant and library acquisitions provided directly to systems. All other funding allocated to institutions on behalf of eligible students, primarily those from 18-23 years of age.
- Allocation treated as financial aid in three tiers:
 - general stipend to 18-23 year old students allocated only to public institutions (about 50% of current appropriation)
 - stipend to students for academic achievement allocated to public or private institutions (about 18% of current appropriation)
 - need-based student financial aid allocated to public and private institutions (about 25% of current appropriations).

Department of Finance Proposal

- Total appropriation to higher education protected; reallocations within overall system to emphasize three priorities: students with lesser means, students seeking their first degree or certificate, and institutional initiatives that improve quality.
- Base funding increased only for growth in degree/certificate-track undergraduates; reallocation among systems to reflect student income distributions.
- Systems have discretion to set tuition, but required to establish progressive structure recognizing ability to pay.
- Revenue from progressive tuition structure shared between student aid and system quality initiatives.

Task Force Recommendations

Using its statewide objectives, its principles for judging new funding mechanisms, and the proposals submitted to it, the task force makes the following recommendations to the Legislature and the Governor.

Formula

Higher education should be funded through a "base-plus" mechanism, including formula and non-formula components, as outlined in the adjacent chart. Responding to its charge, the Task Force on Post-Secondary Funding believes that its recommended statewide objectives can best be achieved within a mechanism that clearly defines and protects the systems' base budgets, while also including incentives for improved performance.

The recommended formula component that maintains the core of the academic enterprise should recognize fixed and variable instructional costs as well as noninstructional costs. The funding mechanism should also provide for change items that may be requested by the systems in the areas of new initiatives and performance.

The task force emphasizes that unanticipated enrollment growth and modifications to provisions in the ACF formula over the past decade have eroded per student funding. While dollars per student is not a measure of quality, decreases in funding handicap the systems' ability to maintain and improve educational quality. Class sizes have expanded, purchases of library materials and instructional equipment have suffered, and students have been confronted by increasing class availability problems, a contributing factor in the elongation of time to program and degree completion. Improving educational quality, the task force believes, will require the state to make a financial commitment — a strategic investment — to initiatives with the potential to pay long-term dividends.

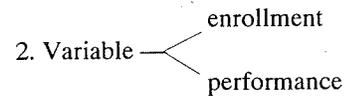
Proposed Fund

Components

I. Base Plus

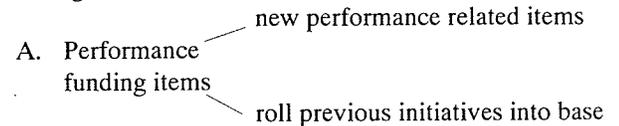
A. Instructional — two components

1. Fixed



B. Noninstructional

II. Change Items



B. Other

Funding Formula

Explanation

I. Base Plus

The funding formula is a "base plus" approach using current definitions of terms below.

A. Instructional

1. A fixed allocation for instructional costs (e.g. those attributed to student support, administration, and physical plant maintenance and operation) that is built on historical costs and based on judgments and standards, and that would fluctuate with significant changes in enrollment based on specified increments.

2. A variable allocation for instructional costs (e.g. those centered on the classroom, including faculty and instructional equipment) that would fluctuate with significant changes in enrollment based on specified increments. Enrollment counted for appropriations should recognize all categories of students, except undergraduate non-residents from non-reciprocity states.

The performance component of up to 1% additional funding above the base should reward institutions for accomplishing agreed upon performance levels as defined by a clear set of expectations and judged by an external evaluation. Portfolios should be used to demonstrate progress, wherever applicable.

B. Noninstructional

An allocation for noninstructional costs (e.g. research, public service) that would be off-formula but subject to performance measures and legislative review.

II. Change Items

A. Performance funding requests could include one-time costs for such things as instructional equipment or curriculum development as well as requests to roll into a system's base budget the cost of successful performance initiatives requiring ongoing expenditures such as reduced class size or student and faculty exchange programs.

B. Requests for new initiatives could be used for a variety of things, including program development on the basis of demonstrated state needs, student assistance in the transition from secondary to higher education, or funding the purchase of equipment that would allow, over time, resource conservation.

Operational

BASE BUDGET

The state should recognize the importance the base budget plays in ensuring and sustaining academic quality and should protect that base through biennial adjustments for inflation. In the event of a budget shortfall, the state should fund as great a percentage of its obligation as possible and provide the systems with the necessary flexibility to create and manage their budgets. The systems, in turn, should set funding priorities in light of the recommended state objectives.

Because the "base" budget governs the core of the academic enterprise, the task force recommends that preserving and, when possible, enhancing the base should be the state's top higher education budget priority. The recommendation includes biennial adjustments for inflation. Preserving the base — including its performance provision — and adjusting it to reflect inflationary increases will provide higher education with the stability it needs to maintain and enhance performance.

The task force further recommends, in light of current and forecast fiscal constraints, that the state provide the systems with maximum flexibility to create and manage their budgets as a means to ensure financial stability.

This can be done, the task force believes, through the establishment of a formal strategy that can be employed if and when budget shortfalls occur, or if full funding of inflation is not possible. The strategy should require each system to develop, for legislative and executive acceptance, its top priorities in line with state objectives. If budget shortfalls occur, or if full funding of inflation is not possible, the systems then should apply funding first to the agreed upon areas of highest priority and then fund additional priorities through increases in tuition or other revenues.

TUITION POLICY

The state should make no changes in its comprehensive cost-related tuition policy, in order to maintain its historical commitment to access and to help ensure Minnesota's quality of life through strong participation.

While the task force devoted extensive time to discussion of student tuition, it ultimately decided to recommend no changes in the current policy. It did, however, unanimously conclude that higher education provides the state with benefits that far exceed its investment. That investment should cover at least 67% of the cost of instruction, the task force believes.

The investment in instruction will assure that the state's historical commitment to access is maintained by

keeping higher education affordable to the vast numbers of people who seek its benefits. It will, at the same time, make certain that Minnesota is continually prepared to meet its challenges through a well-educated citizenry.

Students are viewed as the main beneficiaries of the investment in higher education, but the state also reaps major benefits. Higher education improves the standard of living and the quality of life, making the state a more attractive place for people, businesses and industries to locate. A well-educated citizenry has helped the state become a national leader in health care, high technology, agriculture and education. This commitment to education encourages Minnesotans to be active in their government and enables the state to afford a high level of service to its citizens. Moreover, business and industry directly benefit by having a well-prepared work force and by having education programs available to improve current employee skills.

PERFORMANCE CRITERIA

The public post-secondary systems should develop explicit criteria to place campuses that are not performing well on probation.

The task force believes the systems should assist their institutions to meet high standards of quality and to make wise use of their resources. Although the higher education systems monitor "institutional health" based on such indicators as economic vitality, cost controls and performance, there currently is no explicit criteria for such evaluations, nor is there a formal process by which to deal with institutions that are not performing well. The task force believes a probationary process should be developed to demonstrate to institutions that the state both expects a fair return on its educational investment and is serious about its commitment to quality. The process has the added advantage of serving as an early-warning system for troubled institutions.

The task force believes the systems should be charged, subject to legislative review, with developing the criteria and determining the mechanisms by which institutions are placed on probation. The systems should further be charged with identifying the corrective measures needed, defining the terms and conditions that govern the probation, and administering the process. This should be done in such a way that institutions are assisted in their efforts to make the improvements necessary to become more viable institutions and to use resources more effectively. It should be the responsibility of the systems to determine the possible outcomes of the probation. The systems should also be responsible for informing the Legislature when a campus is placed on probation and for making progress reports to the Legislature during the term of probation.

CONTINUOUS ANALYSIS

Implementation of the new funding mechanism should be accompanied by a process that provides for continuous analysis and refinement as well as a formal review after five years.

The modifications and alterations that re-shaped the ACF formula over the past decade, it is believed, might have been handled more effectively had a process of continuous analysis been employed, and a formal review after five years arguably would have provided benefits to both the state and its higher education systems.

The analysis and refinement process envisioned by the task force would be conducted by legislative staff, finance department staff and representatives of the systems, who would annually report any findings and recommendations to the education committees of the House and Senate. The formal review after five years would include an analytical report on the effectiveness of each of the mechanism's components.

Related

REVIEW OF MANDATES

The state should conduct a comprehensive review of the statutory mandates and executive and legislative reporting requirements that now affect higher education.

Higher education systems and institutions have been affected — in many cases, negatively — by state mandates that govern their operations. The task force believes a comprehensive review of these mandates is warranted, both to determine their effectiveness in achieving desired results and to assess their financial and academic impact.

Throughout the 1980s, increasingly more services have been demanded of higher education, and the Legislature, in many cases, has responded by enacting laws that require such things as child care services, crime and harassment prevention measures, provisions for accessibility and assistance for students with disabilities, immunization verification, extensive reporting requirements, and specific spending from the systems' base budgets for equipment and materials.

Without questioning the values inherent in these mandates, they many times are enacted without an accompanying appropriation, thus eroding the state and student investment in instruction. For that reason, the task force believes the Legislature should conduct a formal review of these statutory mandates and reporting requirements and, based on the information generated, make needed revisions and/or reductions in both the number and scope of these provisions, or fund them adequately.

REWARD SAVINGS

The state should examine and adopt policies that encourage and reward families to save for the costs of their children's education. The policies should be subject to regular reviews and modifications.

Given the increasing cost of attendance and the need for financial aid to be directed at low income students, the task force believes that attention must be given to savings and tax incentive measures for middle income students. The Legislature and Governor have considered such plans before, but the state has yet to take action to encourage and reward families who prepare to invest in their children's future.

The federal government has created a savings plan through its EE Bonds, but it has not received widespread attention. The state may be able to build on this approach or may prefer to develop its own mechanisms. While the specifics of this issue are beyond its purview, the task force recommends that the Legislature and Governor develop plans to address this issue.

“We talk about access, access, access. What we aren't talking about is the quality of that education. That approach inevitably leads to a certain amount of mediocrity.”

Minnesota State University System Chancellor Robert Carothers: testimony before Minnesota Legislators in 1990

APPENDICIES

TECHNICAL ANALYSIS

Charge

Having developed its recommendations for an alternative funding formula for post-secondary education, the Task Force appointed a technical working group comprised of staff members of the Minnesota Department of Finance, the Senate and House Higher Education Divisions and the higher education systems. The group's charge was to:

Define the data and analytical process needed for implementing the higher education funding recommendations made by the Minnesota Task Force on Post-Secondary Funding.

As part of its charge, the technical working group was to: 1) identify and establish common definitions for the data elements that will be used in the proposed funding model; 2) establish principles for the treatment of major components, including fixed costs, variable costs, instruction, noninstruction, enrollment, and incentive grants; 3) draft a narrative description or instructions for operating the funding model; 4) prepare a series of simulations using known fiscal year data to determine how changes in value and weighting affect the results; and, 5) develop a plan or schedule for phasing in some elements of the model, if necessary, to avoid disruption during the first biennium.

Members

The task force thanks the following people for their work on the technical analysis:

David Berg, University of Minnesota
David Buelow, Senate Higher Education Division
Judy Borgen, Minnesota State Universities
Tom Gilson, University of Minnesota
Lisa Griskey, House Higher Education Finance Division
Ron Hackett, Department of Finance
Edward McMahon, Minnesota State Universities
Susan Nemitz, House Higher Education Finance Division
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Instructional Appropriation Base Calculation

In order to operationalize the funding concept proposed by the task force, a number of components required definition and clarification.

1. Enrollment steps—defined as bands of 2% increments. The incremental change in enrollment would always be in steps of 2%, i.e., 2%, 4%, 6%. The base enrollment on which the band is calculated would be the same for both years of the biennium. The base enrollment year would be the fiscal year prior to the beginning of the biennium.

2. Before the proposed formula would be implemented, the usual average cost funding adjustment correcting estimated FY 1993 enrollment to actual would be made to the FY 1995 intent state appropriation. Estimation corrections would continue to be made each biennium to reflect actual enrollment in the prior biennium and that biennium's base year.

3. The variable portion of the instructional intent state appropriation is 65%. This is the same percentage as is used in marginal cost funding, as it applies to per student funding.

4. Upon implementation of the proposed formula, funded enrollment would include students attending our universities and colleges as part of the Midwest Student Exchange Program, if the Legislature approves, as well as other reciprocity agreements.

5. Non-resident, non-reciprocity undergraduate enrollments would be excluded from funding and, therefore, the simulations.

6. In order to convert in the 1996-97 biennium from the two-year lagged enrollment of average cost funding, a one-time adjustment for the Community Colleges, the State Universities, and the Technical Colleges is recommended. This adjustment is necessary if the new system is to reflect current legislative intent regarding state appropriation per student, an element required in determining any funding changes resulting from enrollment step (band) increases or decreases. This one-time adjustment would not be necessary for the University of Minnesota, except for enrollment components not subject to caps under Commitment to Focus, which expires as of June 30, 1995.

The simulations on the next two pages are included to give the reader an example of how the formula would have affected instructional appropriations for FY 1994 and FY 1995 had the proposed formula been in place rather than average cost funding.

Funding Simulation

Minnesota Community Colleges

FY 1993 Instructional Appropriation Base divided by FY 1991 funded enrollment times 65% equals the variable appropriation per student:

$$\$84,544,000 \div 33,320 \text{ FYE} = \$2,537.33 \times .65 = \$1,649.26$$

FY 1994 estimated enrollment =	34,876	FYE
FY 1991 base	<u>33,320</u>	FYE
Growth	1,556	FYE
4% band	1,333	FYE

Adjustment - FY 1994

$$1,333 \text{ FYE} \times \$1,649.26 = \$2,198,464$$

FY 1995 estimated enrollment =	35,922	FYE
FY 1991 base	<u>33,320</u>	FYE
Growth	2,602	FYE
6% band	1,999	FYE

Adjustment - FY 1995

$$1,999 \text{ FYE} \times \$1,649.26 = \$3,296,871$$

Change in Funding	FY 1994	FY 1995	Total
[listed in thousands]			
Based on Simulation	\$2,198.5	\$3,296.9	\$5,495.4
Based on ACF (actual)	<u>(617.0)</u>	<u>\$3,325.0</u>	<u>\$2,708.0</u>
Difference	\$2,815.5	(\$28.1)	\$2,787.4

Funding Simulation

Minnesota State Universities

FY 1993 Instructional Appropriation Base divided by FY 1991 funded enrollment times 65% equals the variable appropriation per student:

$$\$159,447,000 \div 51,992 \text{ FYE} = \$3,066.76 \times .65 = \$1,993.39$$

FY 1994 estimated enrollment =	49,228	FYE
FY 1991 base	<u>51,992</u>	FYE
Decline	2,764	FYE
4% band	2,080	FYE

Adjustment - FY 1994

$$2,080 \text{ FYE} \times \$1,993.39 = (\$4,146,251)$$

FY 1995 estimated enrollment =	48,625	FYE
FY 1991 base	<u>51,992</u>	FYE
Decline	3,364	FYE
6% band	3,120	FYE

Adjustment - FY 1995

$$3,120 \text{ FYE} \times \$1,993.39 = (\$6,219,377)$$

Change in Funding	FY 1994	FY 1995	Total
[listed in thousands]			
Based on Simulation	(\$4,146.3)	(\$6,219.4)	(\$10,365.7)
Based on ACF (actual)	<u>(1,201.0)</u>	<u>(\$4,778.0)</u>	<u>(\$5,979.0)</u>
Difference	(\$2,945.3)	(\$1,441.4)	(\$4,386.7)

Performance Funding and Incentive Grants

Performance funding refers to a system that incorporates specified achievement expectations into the appropriations process. Achievement of performance goals may or may not be tied to increased or decreased funding, but information about what is achieved through the State's investment should be available to decision makers. To move toward that goal, it is recommended that:

Before August 31, 1994, the Higher Education Advisory Council (HEAC) specify a few broadly defined outcome categories and performance indicators that can inform policy and appropriation decisions.

Each higher education system propose to the 1995 legislative session specific measures and normative goals for each of the outcome categories proposed by the HEAC. Because the missions of various system components differ, these measures and norms should be expected to differ accordingly.

Incentive grants involve additional funding tied to the achievement of specified results. Such grants may be nonrecurring if what is to be achieved requires only a one-time investment or recurring if continued funding is necessary and the results are achieved. The process of putting incentive grants in place depends on the higher education systems proposing projects to the Governor and Legislature. The legislation would specify the performance grants separately with detail as to what is to be achieved and when performance is to be reviewed. The timetable for review may be the following biennial session or a subsequent point if achievement of the objective requires a longer lead time.

Term Definitions

The following terms were identified and some defined as shown.

Spending Base

Would reflect actual spending in a given year. It could be adjusted as it is now for recurring and non-recurring items. Three elements would make up the base – state appropriation, actual tuition receipts and other receipts and fees.

State Appropriation - State general fund revenue, which could include current and/or prior year appropriations.

Actual Tuition Receipts - All tuition receipts posted to the system ledgers per fiscal year from all students enrolled in credit instruction.

Other Receipts and Fees - Actual receipts, other than tuition, that are currently in base spending.

Intent Base

Would be "historical" in nature and would be adjusted as it is now for recurring and non-recurring items. Three elements would make up the base – state appropriation, intent tuition receipts and other intent receipts and fees.

State Appropriation - State general fund revenue allotted by the legislature for the current fiscal year.

Intent Tuition Receipts - (define later if needed)

Excess Tuition Receipts - (define later if needed)

Intent Other Receipts and Fees - non-tuition income that affects the General Fund appropriations and is deposited in the state General Fund or the University of Minnesota General Operation and Maintenance Fund – currently includes only indirect cost recoveries and investment income at the University of Minnesota.

Enrollment

Full Year Equivalent (FYE) - a measure of annual instructional volume that can apply to a degree, diploma or certificate. It can be derived by adding total quarter credit hours of instruction and dividing undergraduate credit hours by 45 and total graduate credit hours by 30.

Headcount - (define later if needed)

Formula Enrollment - All FYE enrollment except for non-resident non-reciprocity students.

Programs

Primary

Instruction
Research
Community/Public
Service
Other -
Financial Aid
Intercollegiate Athletics
Debt Service to School Districts
Flow Through Receipts/State Grants
Federal Funding
Hour Based Training

Support

Academic
Student
Institutional
Plant Operations

Instruction

Direct Instruction - includes compensation of faculty and all supply, material and equipment costs incurred in the delivery of instruction.

Indirect Instruction - includes the portion of the academic, student, institutional and plant operation services that support instruction.

Fully Allocated Instruction - the sum of the direct and indirect instructional costs.

Fixed Costs - Costs that remain relatively constant during a specific period of time, regardless of any change in the number of students enrolled.

Variable Costs - costs that vary, within a specific period of time, with changes in the number of FYE students enrolled.

Note: Generally, direct instruction and student support services would vary within a single fiscal year with any significant changes in the number of students enrolled. Other support services would not. There should be more variance in instruction than in student support services. Within instruction, part-time faculty compensation, materials and supplies vary most directly. Full-time faculty compensation and equipment would vary less. Beyond the one-year time frame, full-time salaries may increase with enrollment increases, but may take longer to decrease (contractual language).

Noninstruction

Direct Noninstruction - includes research, public service and other programs such as the following:

Financial Aid
Intercollegiate Athletics
Debt Service to School Districts
F.I.R.E. Research Center
Carl Perkins Act Federal Funds
State Council for Vo-Tech Education
Hour Based Training
Miscellaneous Receipt Categories

Indirect Noninstruction - includes the portion of the academic, student, institutional and plant operation services that support noninstruction.

Fully Allocated Noninstruction - the sum of the direct and indirect noninstructional costs.

Other

Outcomes - change, measured against a baseline, that should occur if a program is successful. An outcome's definition must specify whose/what's situation, behavior or performance is expected to change; what the expected changes are and how they are to be measured and how much change is expected by when.

Objectives - desired outcomes. To the extent possible, system objectives should be consistent with the task force's objectives for the state's higher education investment.

Indicators - a measure of progress toward achieving an outcome. An indicator should have the following qualities: be a valid measure of the desired outcome; be clearly understandable; and based upon data that can be collected regularly and consistently.

Performance Standards (Targets) - realistic estimates of results expected over a given time period.

Performance Funding - a uniform process for linking decisions regarding increases/decreases in state appropriations to the achievement of target outcomes. Performance funding requires: identification and definition of outcomes and indicators; negotiation of performance targets; measurement of baseline; collection of data; reporting and evaluation of results; an algorithm to link changes in performance indicators to changes in appropriation.

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